

Good morning, Mr. Chairman and members of the Subcommittee.

I am pleased to have this opportunity to visit with you today to discuss organized retail theft rings and how it affects the supermarket industry. My name is Darrell Taylor and I am currently the Director of Loss Prevention for HEB Grocery Company. I have 11 years experience in retail security and loss prevention. With me today is Kay Behrens, HEB's Director of Corporate Law.

HEB Grocery Company is one of the nation's largest privately owned grocery chains and had over 10 billion dollars in sales in our Fiscal Year 2003. HEB was founded in Kerrville, Texas, in 1905 and will be celebrating our 100-year anniversary in 2005. HEB currently employs approximately 58,000 employees and operates over 300 stores throughout Texas and internationally in Mexico.

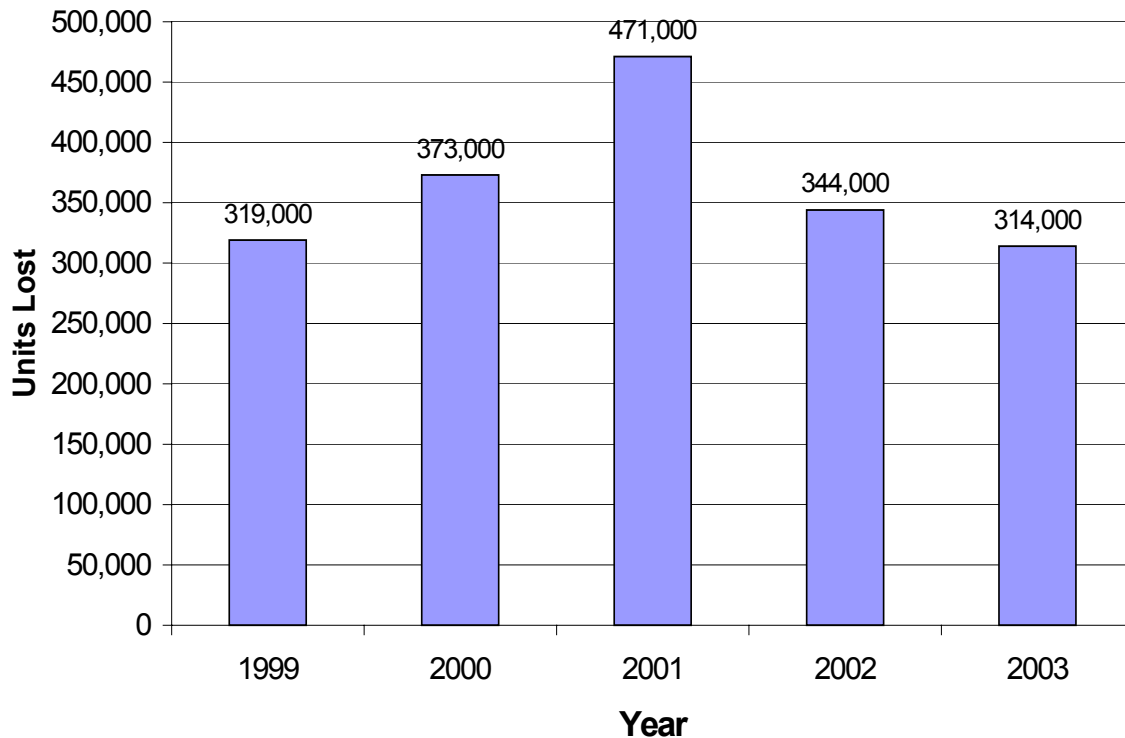
HEB is losing an estimated \$8 million annually in merchandise through organized retail theft, which has become one of HEB's most pressing security problems. Separate and distinct from petty shoplifting, organized retail theft involves professionals who target specific items for resale, and then reintroduce these items into the legitimate marketplace.

Organized theft rings typically target everyday household commodities and consumer items that can be easily sold through fencing operations, flea markets and swap meets. Even the Internet is being used to sell these stolen products. In fact, a simple search on eBay will list pages of household commodities for sale "in never-used, mint condition and in unopened packages." These "new" products listed on eBay are priced significantly below the fair market value of the item.

By analyzing items invoiced to our stores against our store sales, we have discovered variances that suggest HEB is being victimized by organized retail theft operations due to the types of products and quantities involved. Specific products which are being targeted include: infant formula, razor blades, cough and cold medications, batteries, film, cigarettes and cosmetic items. In comparing our data with data of other security professionals, we have found that these same items are being targeted throughout the retailing industry.

Of particular concern to HEB is the organized retail theft of consumable items such as infant formula. An analysis of our numbers suggests that HEB lost an estimated 314,000 cans of infant formula in our Fiscal Year 2003 (see chart below). Therefore, the financial impact of this theft is significant to our company.

Estimated Units of Baby Formula Lost Annually



However, more important than the financial impact of this theft to HEB is the potential health risk that this problem poses for young babies. We believe that the organized retail theft of 314,000 cans of infant formula last year created 314,000 chances that somewhere in the United States a mother could be feeding her child infant formula which she purchased outside the normal and established distribution chain and which could prove unsafe. This number increases dramatically if you assume that other retailers in Texas and throughout the country are suffering similar losses of infant formula through organized retail theft.

How does organized retail theft pose a health risk for young babies? In many cases after infant formula has been stolen, the products are not kept under ideal or required storage conditions. These adverse conditions can threaten the integrity of the product. For example, extreme heat or cold can affect the nutrient content or physical appearance of infant formulas. Furthermore, organized retail theft rings may create counterfeit labels for the products or alter the expiration dates of the products. As a result, when these products make their way back into the legitimate distribution chain, mothers may be feeding their babies unsafe or adulterated products.

We believe that organized retail theft rings target infant formula for the following reasons:

1. **Demand:** Infant formula is in high demand, especially in Texas which has one of the largest growing populations of any state. Part of this high demand is subsidized by the State of Texas which assists approximately 800,000 Texas families in purchasing infant formula through its WIC (Women, Infant, Children) program (which is administered by the Texas Department of Health).

2. **Profits:** There is a very high profit margin in selling stolen infant formula, whereas the profit margin is negligible when the sale is made through legitimate distribution channels.

For example, assume that HEB purchases infant formula from a national branded manufacturer at \$11.99 per can. Also assume that HEB sells a great percentage of its formula to families assisted by the WIC program. According to the Texas Department of Health's records, approximately 25% of WIC families purchase their infant formula from HEB.

The Texas Department of Health has established a guaranteed redemption allowable for purchases made by WIC customers. If the redemption allowable is \$12.00 per can, then HEB will realize a .01 profit on the sale of infant formula to a WIC customer.

However, assume that another retailer purchases infant formula "off the street" for \$5.00 per can. This retailer can resell the product to a WIC family and still be guaranteed a redemption fee of \$11.99 from the State of Texas. Therefore, a retailer's profit is substantial when purchasing from organized retail theft rings as opposed to purchasing from national manufacturers of infant formula.

3. **Risk:** Currently the risk to a shoplifter of infant formula is minimal. When a shoplifter is caught, his/her exposure to significant prosecution is minimal, as most of these criminal acts (i.e. shoplifting) are currently not identified as part of a larger criminal enterprise. Therefore the risk of participating in organized retail theft of infant formula is far smaller than the potential returns to be made on selling the stolen formula.

The end result of the infant formula theft problem is that some mothers could unknowingly feed their babies potentially unsafe formula due to the theft which exists in this commodity and the ease in which it can be reintroduced into the consumer supply chain. HEB's concern about the theft of infant formula and its potential effect on our youngest customers – our children - has prompted us to join a WIC Task Force headed by the Gulf Coast Retailers Association.

HEB has long supported efforts to ensure that all of our customers have access to quality food products, whether it is through the use of food stamps, food banks or other nutrition programs. In fact, HEB provides millions of dollars in financial support and food donations to food banks. HEB is also proud to partner with state and federal governments to ensure that recipients of WIC are able to purchase unadulterated and properly labeled infant formula at our stores. We therefore support the initiatives of the WIC Task Force to combat the organized retail theft problem involving infant formula, including the Task Force's proposal that a national law be enacted requiring retailers of WIC products to purchase such products exclusively from authorized product suppliers.

This problem must be handled on a national level in order to ensure that the problem does not migrate from one state to another.

We appreciate the opportunity to provide you with our insights into this problem. I would be happy to answer any questions you may have.